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SENSITIVE  
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SUBJECT: KOSOVO: PROMOTING REFORM AND RATIONALITY IN  
BUDGETING AND SOCIAL/LABOR SECTORS

SENSITIVE BUT UNCLASSIFIED -- PLEASE HANDLE ACCORDINGLY.

11. (SBU) SUMMARY: For many Kosovars, the declaration of independence in February was a sign that tough economic times were coming to an end, leading to more development, more jobs and more benefits for all. Nearly a year after independence, Kosovars are still waiting for and expecting significant improvements to their social situation, from higher civil service salaries, to increased social benefits payments, to more employment opportunities, without regard for the actual capacity of the GOK to deliver such largesse. The Kosovo Consolidated Budget is not in a position to absorb a significant increase in recurring obligations, yet the GOK has had difficulty managing the enormous expectations of the many groups demanding more assistance. Kosovo lacks a foundation for pension, health and labor laws to help guide GOK responses to demands for increases in benefits. As a result, government officials find themselves pressured to make ad hoc policy decisions that are not properly vetted for budgetary impact, including with the IMF. A government-wide review of current policies and practices that would ideally lead to comprehensive social sector reform is sorely needed, and has been advocated strenuously by international donors. Solid policies in these areas will lead to stronger economic growth and development, and sound fiscal management. While much remains to be done, steps in this direction are being taken with the assistance of the international community, particularly in the areas of public administration reform, implementing sound budget and fiscal management practices, and drafting a social sector white paper to provide a foundation from which to develop broader policies. We see our primary role as providing the political muscle to make certain the GOK keeps to this reform agenda, which will ultimately lead to job creation and a more stable economic environment. END SUMMARY.

Overview of Labor and Social Welfare Sector  
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12. (U) Unemployment in Kosovo is the highest in Europe, around 40% according to a 2007 IMF Aide Memoire. According to the Ministry of Labor and Social Welfare (MLSW), approximately 90 percent of registered unemployed are

long-term unemployed, meaning without work for longer than two years. The Ministry of Economy and Finance's (MEF) Macroeconomic Unit estimates that 30,000 Kosovars enter the workforce every year, with young people between the ages of 16-25 comprising the overwhelming majority of this group. The challenge of finding stable employment in Kosovo has forced many young people to participate in the informal economy or immigrate illegally to other European countries to find work. According to the Ministry of Labor and Social Welfare (MLSW), 15 percent of Kosovo's population is living in extreme poverty (less than one dollar/day according to UNDP), and 45 percent is living in relative poverty (less than two dollars/day). Families eligible for social assistance benefits receive 60 euros per month, approximately USD 76.00.

¶3. (U) In order to halve the current unemployment rate by 2020, the Macroeconomic Unit estimates that Kosovo must achieve a constant 7.3 percent GDP growth rate, while a growth rate of 4.7 percent will keep current unemployment rates stable. According to a 2008 IMF Aid Memoire, Kosovo's 2007 GDP growth rate was estimated at only 4.1 percent. Although the IMF predicts a 6.1 percent growth rate for 2008, this growth is fueled primarily by short-term post-independence government expenditures versus long-term private capital investment. The largest single employer in Kosovo is the government. The Kosovo Tax Administration estimates that around 75,000 people are employed in the public sector, earning an average monthly wage of 224 euros, compared to 275 euros per month in the private sector.

¶4. (U) Kosovo has replaced the old Yugoslav pay-as-you-go

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(PAYG) pension plan with a two pillar pension program intended to provide at least some coverage for all Kosovo citizens. The first pillar is a "basic" universal pension plan financed by the Kosovo Consolidated Budget. All individuals aged 65 and older are qualified to receive benefits of 40 euros per month from the basic plan. In March 2008, the MLSW began payment of an additional 35 euros per month to individuals who contributed to the old Yugoslav PAYG system. The second pillar is a "funded" pension system, similar to the Thrift Savings Plan implemented in the U.S. These pensions are funded by mandatory contributions of five percent each from the employee and the employer. The monies are invested in capital markets to provide future retirement income, and the funds remain the property of the contributing employee. The Kosovo Pension and Savings Trust (KPST) has been established to administer the funded system.

State of the Unions

¶5. (U) Kosovo has a number of active unions, varying in objective, size and aggressiveness. There are two large umbrella trade unions, the Kosovo Federation of Independent Trade Unions (BSPK) and the Confederation of Free Union of Kosovo (SKLK). The BSPK grew out of the former Yugoslav socialist trade union and assumed an independent political role as the main organization coordinating miners strikes during the 1980,s and 1990,s. BSPK has not had a major political role since 1999 but still claims to have over 100,000 members who are largely long-term unemployed. The union occasionally organizes protests and strikes but depends heavily on political support to carry out an event, even to the extent of needing assistance transporting strikers to a demonstration site. In early 2007, the BSPK split and the SKLK was formed by the former BSPK president, who now heads the new union. The SKLK claims a membership base of 25,000 people, all employed. The two unions refuse to cooperate with each other due to personality conflicts, and the BSPK does not recognize the "legitimacy" of the SKLK. There are also many smaller unions representing specialized interests, including a civil servants union, a Kosovo Electric Corporation (KEK) union, a pensioners union, a teachers

union, and a Trepca miners union, among others. These unions may or may not be associated with either of the two umbrella unions.

¶6. (U) Since independence, the GOK has been approached by numerous groups asking for special consideration of their situation. Refusal to meet union demands, or even to have a meeting, has usually resulted in a strike, demonstration or some other demonstrative effort to protest GOK unresponsiveness. On May 1, International Labor Day, BSPK staged a general demonstration in front of the main government building. Thousands of mostly elderly unemployed workers protested in front of the main government building demanding better workers, rights protections and an increase in social benefits. Demands included, among other things, social dialogue between the government and BSPK, adoption of a new labor law, and establishment of social, pension and disabled worker funds.

¶7. (U) As happens every year in August, teachers threatened a nationwide strike if salaries were not increased. A last-minute agreement between the government and the teachers union granted teachers a salary increase based on their level of experience. Other social and labor groups took note of this reward. Health workers subsequently organized several strikes with demands for higher wages and better working conditions. The strikes themselves were not widespread, most likely because of the Minister of Health's promise to provide a 44 euro per month raise for all health sector employees. After teachers and health workers had secured at least a portion of their demands, other groups started clamoring for their share. The Judiciary Trade Union threatened to strike if its members wages were not also raised. The Customs

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Service Trade Union gave the government 15 days to review its request for a minimum 100% pay increase on the base salary for all officers, plus health insurance, an increase in annual leave accrual based on time in service, and a daily per diem of at least three euros to cover meals. The union representing the Kosovo Police Service also threatened to protest over salaries and incentive pay, but canceled the event after reaching agreement with the GOK. The Trepca miners union also demanded higher salaries and pensions. Representatives of Kosovo's pensioners were promised by Deputy Prime Minister Kuci that a new pension law would be submitted to the Assembly before the end of the year, with higher pay-outs for all pensioners. In an apparent effort to hold back the rising tide of demands, the GOK also decided to shorten the work week for government employees from 40 to 35 hours.

#### Need for Social Sector Policies

¶8. (SBU) The promise of benefits to one group at the exclusion of others has generated a cascade of vociferous demands, demonstrations and threats of strikes. Without a comprehensive social sector policy approach to help guide their actions and respond to pressure from these groups, the GOK has extended ad hoc agreements for increased benefits and wages. This led to extreme dissatisfaction among the remaining groups not receiving additional benefits, further feeding the cycle of pressure on the GOK. Not only has this struck a bad tone in government-union relations, it has also significantly undercut the government's fiscal discipline. The final cost of these many individual promises has been wholly unsustainable by the KCB, putting the GOK in the even more difficult position of trying to manipulate the budget to honor its commitments, while at the same time keeping the final amount under overall IMF spending caps. In the end, and with a high degree of involvement by Embassy Pristina, the GOK submitted a budget in December awarding a 10 percent across-the-board salary increase to all public sector employees, with the exception of teachers, who were allowed to retain a higher increase based on experience -- and

keeping the final amounts within IMF-recommended spending caps.

¶9. (SBU) Unfortunately, these actions have not been accompanied by substantive policy reforms in public administration or the civil service, increasing the likelihood that the GOK will be forced into the same situation again next year. In lieu of developing comprehensive social and labor policies, the government has allowed itself to be burdened by efforts to introduce several pieces of expensive legislation awarding new and discrete benefits to individuals designated alternately or concurrently as political prisoners, martyrs or war heroes. Not only do these laws have the potential to bust the budget, they are being proposed in the absence of a foundation for pension, labor and health laws. The ad hoc nature of this legislating also threatens to leave out segments of the population unable to obtain such a special designation in order to receive more benefits. Implementing sound base laws would provide a much needed framework to address follow-on legislation that awards benefits to discrete groups, as well as assess the fiscal feasibility of the proposed new laws.

#### Addressing the Policy Challenges

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¶10. (SBU) In order to assist the GOK in meeting these significant policy challenges, international donors are working closely with the government to develop and implement projects that will allow meaningful social sector reform. The World Bank's Economic Policy and Public Expenditure Management Technical Assistance Project (PEMTAG II) will be extended into 2009, and has been tackling key public expenditure management problem areas within high-spending GOK

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ministries, including budget formulation, budget execution, and following proper procurement procedures, all areas that need to function in tandem with any newly proposed legislation. In acknowledgment of the increasing public pressure on the GOK to create more jobs, the World Bank also plans to support two job creation projects in the future. The Business Environment Technical Assistance Project, scheduled to run into 2010, will focus on improving the business environment in Kosovo by clearly outlining regulatory processes, improving delivery of business services, strengthening property rights, and increasing transparency and accountability of implementing institutions, in order to encourage more business growth in Kosovo. The Sustainable Employment Development Policy Program (SEDPP) is still in the preparatory stages, but is envisioned to encourage reforms and provide program implementation support in the areas of education, health, social protection and public sector governance, as well as fostering sustainable employment in these areas.

¶11. (SBU) Britain's Department for International Development (DFID) is also supporting social sector reform initiatives, and is currently funding the Functional Review and Institutional Design of Ministries (FRIDOM) project. Taking a "whole government" approach, FRIDOM aims to help all line ministries develop fiscally sustainable restructuring plans, while also assisting the GOK with devising a similar strategy for reforming the overall architecture of Kosovo's public administration. Public financial management reform and public administration reform were also areas of concern discussed at the July 2008 Kosovo donors conference and based on this discussion, and in cooperation with other donors, the World Bank and DFID are taking steps to establish new and strengthened approaches for implementing GOK-driven reform strategies. Although still in the design stage, anticipated government-wide outcomes of this initiative include the establishment of a credible and sustainable public financial management policy setting process; strengthening budget development execution and controls; improving linkages between policy and priority setting; and using performance

measurement and monitoring tools in planning. These are all essential tools the GOK needs to make sound policy decisions that correspond with fiscal realities, while at the same time addressing key social sector needs.

¶12. (SBU) COMMENT: The bad news is that Kosovo has a long way to go to establish sound social and labor policies that, as a result, will one day meet citizens' expectations for job creation and a stable economic environment. The good news is that, with the World Bank and DFID taking the lead, there is technical assistance to bring reform and rationality to the budgeting and entitlement process in Kosovo, including a new grade and salary system for the public sector. A few steps in the direction of this process have already been taken: with GOK agreement, the World Bank is developing a public administration reform program and the EC is assisting the Labor and Social Affairs Ministry with drafting a social sector white paper that will provide a foundation for pension, labor and health laws, promised by the GOK at the July Kosovo donors conference. We see our role as providing the political muscle to make this happen and to keep the GOK on the right path to develop the sound policies needed to foster economic growth and job creation that reaches all corners of Kosovo.

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